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# Travel Market Analysis 2002 - 2004

Prepared For The National Commission To Ensure Consumer Information And Choice In The Airline Industry

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## Background And Objectives

On May 16, 2002, the Secretary for the Department of Transportation announced the establishment of the National Commission To Ensure Consumer Information And Choice In The Airline Industry (NCECIC). This Commission was created by the Aviation Investment and Reform Act for the 21st Century (AIR-21) to study the market position and general condition of traditional retail travel agencies in today's competitive market for the sale of travel services.

The Commission has engaged PhoCusWright Inc. to identify whether the financial condition of travel agencies is declining as a result of the migration to online tools and access to Web fares, and, if so, the effect that this will have on consumers.

## Key Forces Impacting Market Dynamics

The financial condition of travel agencies today, and in the future, is defined by a series of market forces, business factors and purchase dynamics. These include elements such as the current and future size and composition of the market, channels of access, revenue composition, product mix, operating business models, buyer behavior and supplier relations. All of these elements will be examined within this report in order to quantify and assess the financial state of U.S. based travel agencies.

These factors will be evaluated within the context of the leisure/unmanaged business travel market. This market consists of purchases by vacationers and business travelers who are not bound by corporate policy to make their travel selections. All figures are represented in U.S. dollars and reflect gross bookings generated from travel with U.S.-based suppliers.

Where data are applicable, the smaller travel agency market will also be analyzed. The smaller travel agency market is defined as an agency with less than $1 million in air volume, as reported through the Airline Reporting Corporation.

# Summary Of Findings

## Size Of The U.S. Travel Market

The entire U.S. travel market (including leisure/unmanaged and corporate travel) was US$209.1 billion in 2001. More than five out of every 10 travel dollars (56.3%) spent with U.S. suppliers was for a leisure/unmanaged business trip, or $117.6 billion. While the size of the leisure/unmanaged market will grow through 2004, the expenditure ratio (of leisure to corporate) will remain stable at 57.4%. Both sectors of the market will experience growth through 2004, with leisure/unmanaged expected to grow at a rate almost double that for the corporate sector.

**Table 1**
**U.S. Travel Market, By Travel Sectors**
**Gross Bookings (US$Millions)**

| Travel Sectors | 2001 | Share | 2004 | Share | % Change (2001 Vs. 2004) |
|---|---|---|---|---|---|
| Leisure/Unmanaged | $117,650 | 56.3% | $130,050 | 57.4% | +10.5% |
| Corporate (managed) | 91,450 | 43.7% | 96,450 | 42.6% | +5.5% |
| Total | $209,100 | 100.0% | $226,500 | 100.0% | +8.3% |

Source: PhoCusWright Inc. Copying prohibited.

## Channels Of Access

### Travel Agency Vs. Direct Channel Market Share

A travel distribution channel refers to the method or place that a traveler uses to investigate and purchase travel. These include offline and online intermediated and direct channels of access to inventory. While more than one channel may be accessed for information, price comparison, purchase, etc., this report attributes gross bookings to the channel where the purchase is made.

Travel agencies are the dominant mode by which travelers make reservations. In fact, more than six out of every $10 (60.3%) generated from leisure/unmanaged bookings are completed through an intermediated channel. Together, offline and online travel agencies generate $71 billion in 2001 gross bookings. While the travel agency channel will grow modestly through 2004 (3%), traditional agency bookings will be cannibalized by the growth in online agency and online direct competitors. This is reflected in a weakened market position in 2004 when offline agency market share drops to 43.3%. In fact, online channel growth will cause market consolidation of players in both online and offline arenas. As reported in the table below, the *PhoCusWright 2001 Consumer Travel Trends Survey* shows that online travel growth is (and will continue to be) at the expense of travel agencies. As in any "contracting" industry and industry projected for moderate growth, traditional agencies unable or unwilling to adopt Web-based technologies and diversify to more profitable offerings will close.

As suppliers aggressively drive distribution costs out of their business and travelers directly to their Web sites, the online direct channel will realize significant growth through 2004. In fact, the online direct category will equal the share of bookings generated through traditional agencies for the first time since de-regulation. This underscores the price competitive force that suppliers will wield for agency customers. This will force traditional agencies to continue to handle the higher priced, more complex leisure/unmanaged travel and customers willing to spend more on travel. This higher level of spending among travel agency users was also reported in the *Travel Weekly's U.S. Consumer Travel Survey (2001)*. The study found that travelers who use agencies spend nearly twice as much on leisure trips annually as those who do not use agencies.

**Table 2**
**Leisure/Unmanaged U.S. Travel Market, By Channel**
**Gross Bookings (US$Millions)**

| Channel | 2001 | Share | 2004 | Share | % Change (2001 Vs. 2004) |
|---|---|---|---|---|---|
| Travel Agency (NET) | $70,991 | 60.3% | $73,100 | 56.2% | +3.0% |
| Online Travel Agency | 8,015 | 6.8% | 16,765 | 12.9% | +109.2% |
| Offline Travel Agency | 62,976 | 53.5% | 56,335 | 43.3% | -10.5% |
| Direct (NET) | $46,659 | 39.7% | $56,950 | 43.8% | +22.1% |
| Online Direct (supplier Web sites) | 10,729 | 9.1% | 22,768 | 17.5% | +112.2% |
| Offline Direct (phone/fax) | 32,230 | 27.5% | 30,182 | 23.2% | -6.4% |
| Offline Walk-in | 3,700 | 3.1% | 4,000 | 3.1% | +8.1% |
| Total | $117,650 | 100.0% | $130,050 | 100.0% | +10.5% |

Source: PhoCusWright Inc. Copying prohibited.

### Offline Vs. Online Channel Market Share

Offline channels accounted for 84.1% of all leisure/unmanaged gross bookings in 2001. This channel, however, will shrink by 8.6% in gross bookings by 2004. While offline will continue to be the dominant method for purchasing leisure/unmanaged travel, this drop in share will be lost to online reservation options. The offline travel agency channel will be most affected by this shift, losing one-tenth of its gross revenue during this period.

Operational efficiencies, an expanding base of customers and a diversified product offering will push the online channel's gross revenue from 15.9% (2001) to almost one-third of the leisure/unmanaged market in three years. This category will grow 110.9% to $39.5 billion through 2004, as a result of the explosive growth of both the online agency and supplier Web sites. This growth is being fueled, in part, by a multi-channel dynamic. This refers to the purchase behavior associated with investigating options through one channel and booking via another. As consumers' use of the Internet matures, a portion of these consumers will use online tools for investigating and booking travel. PhoCusWright estimates that consumers who investigate product availability and price options online, and then purchase offline, represent 15% of offline travel agency bookings. While this underscores the importance and confidence consumers place in travel agencies for booking leisure/unmanaged travel, it does point to the influence of the Internet on purchasing behavior through 2004. The *PhoCusWright 2001 Consumer Travel Trends Survey (2001)* identified that half of all online travelers who have researched travel online bought that travel product offline. By embracing Web-based tools, offline agencies can capture a portion of this “multi-channel” market.

At roughly a 7% share of the total travel market, online travel agencies have not begun to saturate the marketplace. Leading online travel agencies will continue to grow (109.2%) as the market expands, selling more hotel and complex travel. Small players (Cendant's Trip.com) and new entrants will gain traction as vacation packaging sites. Previously mediated by the Internet, supplier chains like Starwood, Marriott and Cendant are attempting to re-establish direct relationships with customers. Cruise companies and tour operators are (slowly) offering consumer bookings on their Web sites as well. Attracting consumers directly will cause this segment's share to double. These efforts will be at the heart of the projected share growth through 2004.

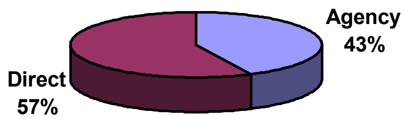
**Table 3**
**Leisure/Unmanaged U.S. Travel Market, Online Vs. Offline Gross Bookings (US$Millions)**

| Channel | 2001 | Share | 2004 | Share | % Change (2001 Vs. 2004) |
|---|---|---|---|---|---|
| Offline (NET) | $98,906 | 84.1% | $90,517 | 69.6% | -8.6% |
| Offline Travel Agency | 62,976 | 53.5% | 56,335 | 43.3% | -10.5% |
| Offline Direct (phone/fax) | 32,230 | 27.5% | 30,182 | 23.2% | -6.4% |
| Offline Walk-in | 3,700 | 3.1% | 4,000 | 3.1% | +8.1% |
| Online (NET) | $18,774 | 15.9% | $39,533 | 30.4% | +110.9% |
| Online Travel Agency | 8,015 | 6.8% | 16,765 | 12.9% | +109.2% |
| Online Direct (supplier Web sites) | 10,729 | 9.1% | 22,768 | 17.5% | +112.2% |
| Total | $117,650 | 100.0% | $130,050 | 100.0% | +10.5% |

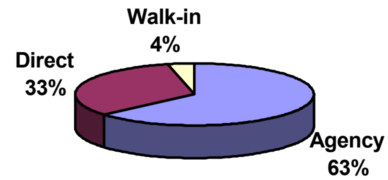
Source: PhoCusWright Inc. Copying prohibited.

The following charts indicate that travel agencies operate more comfortably and effectively in the offline arena and suppliers more efficiently in the online arena. Traditional agencies must develop an Internet presence in order to prevent customer "churn" and loyalty directly with suppliers. The Internet will also help traditional agencies pre-qualify travelers who use the Internet for comparison-shopping, and convert them to clients. Looking at only offline channels, agencies dominate the market at 63% as consumers continue to ascribe value to the expertise and services of the travel agent, particularly among more complex trips. This per channel distribution will shift little through 2004.

**Table 4**
**2001 Channel Share Of Gross Bookings**




Base: Online Travel Market




Base: Offline Travel Market

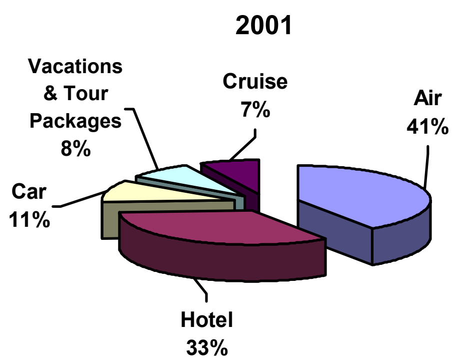
Source: PhoCusWright Inc. Copying prohibited.

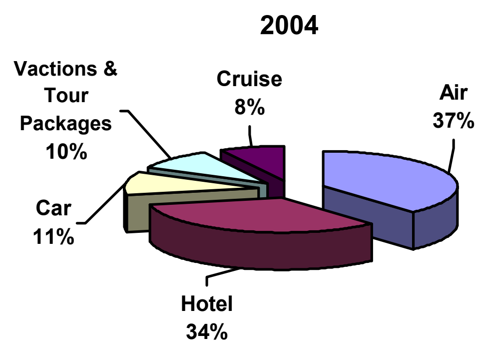
## Product Mix Disposition

### U.S. Total Travel Market

Overall and regardless of the booking channel, air continues to account for the largest percentage of total gross bookings, at 41%. Together with hotel, these product lines represent almost three-fourths of all sales generated last year. This will drop slightly in 2004 (to 71%), as a result of price promoting air due to online competition. The tour and cruise categories will experience the greatest growth, due to a greater online presence and higher commission structure.

**Table 5**
**U.S. Total Travel Market, By Product Mix**
**Gross Bookings**




Source: PhoCusWright Inc. Copying prohibited.

**Leisure/Unmanaged U.S. Travel Market**

In the leisure/unmanaged travel market gross bookings were $117.6 billion in 2001. Hotel and air each accounted for approximately one-third of the industry's volume at approximately $38 billion. Their almost equal weighting of gross bookings is due to the fact that only one-third of all leisure travelers travel by air.

From 2001 to 2004, the leisure/unmanaged market will grow moderately (10.5%) to $130 billion due to the expanding vacation/tour packages and cruise categories. Therefore travel agencies must target the vacation/tour and cruise categories that will experience double-digit growth during this period. In comparison, air will experience a very small increase (2.4%) as a result of the price elasticity of online air travel and the migration of point-to-point travel purchases away from offline channels.

**Table 6**
**Leisure/Unmanaged U.S. Travel Market, Travel Growth by Segment**
**Gross Bookings % Change (2001 Vs. 2004)**

| Segment | % Change (2001 vs. 2004) |
|---|---|
| Vacations & Tour Packages | +29.4% |
| Cruise | +15.9% |
| Car | +9.1% |
| Hotel | +8.6% |
| Air | +2.4% |
| Total | +10.5% |

Source: PhoCusWright Inc. Copying prohibited.

**Travel Agency Vs. Direct Channels**

Consumers rely most heavily on travel agencies for their purchase of air, car, vacations and cruises as this channel provides breadth of information and the ability to price shop. Hotel is, and will continue to be, most often purchased directly with the chain or property.

**Table 7**
**Leisure/Unmanaged U.S. Travel Market Product Mix, By Channel Category**
**2001 Gross Bookings (US$Millions)**

| Channel | Air | Air Share | Hotel | Hotel Share | Car | Car Share | Vacations | Vacations Share | Cruise | Cruise Share |
|---|---|---|---|---|---|---|---|---|---|---|
| Travel Agency (NET) | $23,851 | 62.4% | $12,100 | 31.4% | $5,950 | 67.6% | $14,790 | 87.0% | $14,300 | 94.7% |
| Direct (NET) | $14,399 | 37.6% | $26,400 | 68.6% | $2,850 | 32.4% | $2,210 | 13.0% | $800 | 5.3% |
| Total | $38,250 | 100.0% | $38,500 | 100.0% | $8,800 | 100.0% | $17,000 | 100.0% | $15,100 | 100.0% |

Source: PhoCusWright Inc. Copying prohibited.

Travel agency revenue will be cannibalized by suppliers' push to drive sales directly to their Web sites through Web fares, deeper loyalty incentives and with low cost/high touch technology. This shift will account for a 12.2% drop in gross air bookings and a 2.5% drop in gross car bookings from 2001 to 2004 for travel agencies in general. As expected, both online and offline travel agencies will accelerate their cruise and vacations offerings in an effort to offset the loss in air revenue and diversify their revenue stream. Although it will decline as a slice of the pie, the travel agency channel will still represent 91% of all cruise sales in 2004.

By 2004, direct channels will account for almost half (46.5%) of all gross air bookings in the leisure/unmanaged marketplace. Cruise lines, as well, will mature their Internet site from an online brochure to an electronic direct mail device to a low-cost tool through which to sell excess inventory online. This will be particularly important as the number of first-time (price-sensitive) cruisers increases and a large share of potential cruisers do not use travel agencies.

**Table 8**
**Leisure/Unmanaged U.S. Travel Market Product Mix, By Channel Category**
**2004 Gross Bookings (US$Millions)**

| Channel | Air | Air Share | Hotel | Hotel Share | Car | Car Share | Vacations | Vacations Share | Cruise | Cruise Share |
|---|---|---|---|---|---|---|---|---|---|---|
| Travel Agency (NET) | $20,950 | 53.5% | $12,850 | 30.7% | $5,800 | 60.4% | $17,600 | 80.0% | $15,900 | 90.9% |
| Direct (NET) | $18,200 | 46.5% | $28,950 | 69.3% | $3,800 | 39.6% | $4,400 | 20.0% | $1,600 | 9.1% |
| Total | $39,150 | 100.0% | $41,800 | 100.0% | $9,600 | 100.0% | $22,000 | 100.0% | $17,500 | 100.0% |

Source: PhoCusWright Inc. Copying prohibited.

**Table 9**
**Leisure/Unmanaged U.S. Travel Market Product Mix, By Channel Category**
**Gross Bookings % Change (2001 Vs. 2004)**

| Channel | Air | Hotel | Car | Vacations | Cruise | Total |
|---|---|---|---|---|---|---|
| Travel Agency (NET) | -12.2% | +6.2% | -2.5% | +19.0% | +11.2% | +3.0% |
| Direct (NET) | +26.4% | +9.7% | +33.3% | +99.1% | +100.0% | +22.1% |
| Total | +2.4% | +8.6% | +9.1% | +29.4% | +15.9% | +10.5% |

Source: PhoCusWright Inc. Copying prohibited.

## Offline Vs. Online Agency Channels

The offline agency channel will continue to be the primary method by which all products (excluding hotel) will be purchased. However, the rapid adoption of the Internet for travel reservations will pull share away from offline channels over the next three years. This is because the more a product becomes commoditized, the less an offline agency is valued for its expertise and knowledge. For these products, price determines through which channel the product is purchased. This is true for air and car, as reflected by significant 2004 losses of 33.8% and 26%, respectively. Consumers will increase their purchase of all types of travel through online agencies as more providers or options are available in the market, market consolidation takes place and consumers are presented with lower fares/rates and online agencies expand their product offering to include cruise and tour. Online use will be accelerated the more a consumer perceives and/or receives lower prices online.

Online travel agency and supplier direct gains will be at the expense of offline agency losses. Online agency market share of gross air bookings will be almost double above 2001 levels (12.8%) in 2004 (21.5%), primarily as a result of converting offline agency users. In addition, online agencies and supplier Web sites will help expand the cruise and vacation markets by attracting younger, more price sensitive and, often, first time consumers to this type of travel.

**Table 10**
**Leisure/Unmanaged U.S. Travel Market Product Mix, Online Vs. Offline Agency 2001 Gross Bookings (US$Millions)**

| Channel | Air | Air Share | Hotel | Hotel Share | Car | Car Share | Vacations | Vacations Share | Cruise | Cruise Share |
|---|---|---|---|---|---|---|---|---|---|---|
| Travel Agency (NET) | $23,851 | 62.4% | $12,100 | 31.4% | $5,950 | 67.6% | $14,790 | 87.0% | $14,300 | 94.7% |
| Online Travel Agency | 4,895 | 12.8% | 1,850 | 4.8% | 950 | 10.8% | 170 | 1.0% | 150 | 1.0% |
| Offline Travel Agency | 18,956 | 49.6% | 10,250 | 26.6% | 5,000 | 56.8% | 14,620 | 86.0% | 14,150 | 93.7% |
| Total | $38,250 | 100.0% | $38,500 | 100.0% | $8,800 | 100.0% | $17,000 | 100.0% | $15,100 | 100.0% |

Source: PhoCusWright Inc. Copying prohibited.

**Table 11**
**Leisure/Unmanaged U.S. Travel Market Product Mix, Online Vs. Offline Agency 2004 Gross Bookings (US$Millions)**

| Channel | Air | Air Share | Hotel | Hotel Share | Car | Car Share | Vacations | Vacations Share | Cruise | Cruise Share |
|---|---|---|---|---|---|---|---|---|---|---|
| Travel Agency (NET) | $20,950 | 53.5% | $12,850 | 30.7% | $5,800 | 60.4% | $17,600 | 80.0% | $15,900 | 90.9% |
| Online Travel Agency | 8,400 | 21.5% | 3,850 | 9.2% | 2,100 | 21.9% | 1,540 | 7.0% | 875 | 5.0% |
| Offline Travel Agency | 12,550 | 32.1% | 9,000 | 21.5% | 3,700 | 38.5% | 16,060 | 73.0% | 15,025 | 85.9% |
| Total | $39,150 | 100.0% | $41,800 | 100.0% | $9,600 | 100.0% | $22,000 | 100.0% | $17,500 | 100.0% |

Source: PhoCusWright Inc. Copying prohibited.

**Table 12**
**Leisure/Unmanaged U.S. Travel Market Product Mix, Online Vs. Offline Agency Gross Bookings % Change (2001 Vs. 2004)**

| Channel | Air | Hotel | Car | Vacations | Cruise | Total |
|---|---|---|---|---|---|---|
| Travel Agency (NET) | -12.2% | +6.2% | -2.5% | +19.0% | +11.2% | +3.0% |
| Online Travel Agency | +71.6% | +108.1% | +121.1% | +805.9% | +483.3% | +109.2% |
| Offline Travel Agency | -33.8% | -12.2% | -26.0% | +9.8% | +6.2% | -10.5% |
| Total | +2.4% | +8.6% | +9.1% | +29.4% | +15.9% | +10.5% |

Source: PhoCusWright Inc. Copying prohibited.

These trends are supported by data from the *PhoCusWright 2001 Consumer Travel Trends Survey* that indicate that online travelers (defined as Internet users who have flown commercially by air within the past year) have migrated away from traditional agency and telephone channels to purchase travel. In fact, four in 10 usually buy travel from online providers.

**Table 13**
**How Online Travelers "Usually" Buy Travel**

| Year | Travel Agent | Phone Suppliers | Online |
|---|---|---|---|
| 1998 | 55% | 33% | 10% |
| 1999 | 47% | 30% | 19% |
| 2000 | 39% | 29% | 27% |
| 2001 | 26% | 26% | 41% |

Source: PhoCusWright 2001 Consumer Travel Trends Survey. Copying prohibited.

## Impact Of The Small Travel Agency Market

The small travel agency market is defined as entities with less than $1 million in air sales. ARC defines this to include direct air and the air component of a cruise or tour package. Train reservations and any overrides processed through ARC are included in these figures.

Small travel agencies have a dominant presence in the market with more than 12,700 entities in existence in 2001. These figures continue to drop as smaller agencies struggle with profitability and new sales leads. Due to its fragmentation and limited negotiating power these agencies are the most vulnerable within the industry. Even if all of these agencies were to join a consortium or franchised network, they would represent less than 10% of all travel agency sales. While two-thirds of the market is comprised of agencies under $1 million in air sales, this segment now generates only 8% of total commissions and 7.4% of total sales. Not only are offline agencies losing share, smaller agencies (less than $1M) are losing share to larger offline agencies, according to ARC.

**Table 14**
**% Industry Sales Vs. % Commissions Vs. # Of Entities**
**Gross Bookings (2001)**

| Year | <$1M % Of Sales | >$1M % Of Sales |
|---|---|---|
| 2001 | 8.4% | 91.6% |
| 2002 | 7.4% | 92.8% |

Source: ARC, PhoCusWright Inc. Copying prohibited.
Note: 2002 data is an average of 1st/2nd quarter.

## Scenario Analysis

To fully understand the financial condition of travel agencies, PhoCusWright quantified the impact of several scenarios on the operating margin of the average sized agency. While it is difficult to obtain a truly representative agency, the purpose of this scenario analysis was to provide a representative scenario in order to gauge the impact of both strategic and tactical implementations on profitability. Through the use of ARC data and PhoCusWright calculations, the average sized agency is $3.4 million in gross bookings with five employees. Gross bookings, number of bookings and average ticket price were all weighted to reflect a mix of leisure/business and domestic/international bookings. Within this analysis, we considered commission and override revenue, as well as the following costs: salaries (with benefits), rent, communications, advertising/promotion, GDS expenses, miscellaneous overhead, equipment, consultants, travel and entertainment, training and development, professional fees/dues and postage. The top two costs were aligned to optimize travel agency performance, so that "salaries/benefits" and "rent" represented 32% and 6.7% of the budget, respectively.

PhoCusWright evaluated two scenarios to demonstrate their impact on an agency's operating margin in an effort to improve profitability. The scenarios are: (1) shifting the mix of products sold away from air to higher margin products; and (2) implementing service fees to offset commission losses.

### Scenario #1: Impact Of Product Mix Shifts On Operating Margin

The reduction or removal of air commissions continues to challenge agency profitability. While small, simple shifts in the total number of bookings and bookings by product can have a positive impact on operating margin. This typical agency was generating 41%, 4.1% and 5.3% of its bookings from air, tour and cruise, respectively. By reducing the number of air bookings by just 20% and applying that available time to complete more tour and cruise bookings, operating margin improved from -19.3% to -15.8%. While operating margin is still in the red, this single act of freeing agents to work on more profitable business (like cruise and tour), does contribute to improving overall operating margin. The cruise category continues to operate in the red, because of the inherent, labor-intensive nature of booking a cruise. The more agencies use automation to book cruises and tour, the faster this operating margin will move to black.

**Table 15**
**Average Travel Agency Operating Margin, By Shifts In Product Mix**

| Product | Before: Product Mix Shift | After: Product Mix Shift | Before: Total Profit/Loss | After: Total Profit/Loss | Before: Operating Margin | After: Operating Margin |
|---|---|---|---|---|---|---|
| Air | 41.0% | 35.4% | -$111,160 | -$83,572 | -99.1% | -93.1% |
| Hotel | 24.3% | 26.3% | 26,545 | 27,450 | 48.2% | 49.8% |
| Car | 25.3% | 27.3% | -13,322 | -12,182 | -61.9% | -56.6% |
| Tour | 4.1% | 5.1% | 34,512 | 41,118 | 36.6% | 38.3% |
| Cruise | 5.3% | 5.9% | -8,717 | -5,912 | -9.5% | -6.3% |
| Total | 100.0% | 100.0% | -$72,143 | -$54,724 | -19.3% | -15.8% |

Source: PhoCusWright Inc. Copying prohibited.

### Scenario #2:  Impact Of Service Fees On Operating Margin

The decrease/loss of commission revenue has forced some agencies to close and others to find alternative revenue sources.  According to ASTA's Service Fee Report (2001), the average service fee is $13 and more than 85% of all agencies have implemented some type of service fee.  To account for fee increases since this survey was fielded, an average front-end or booking service fee of $16 was used.  This fee was applied to 70% of all bookings to account for fee waivers for multiple bookings and loyal customers.  Under the assumption that this agency had few, if any, preferred suppliers and was not a member of a consortium or franchise network, standard commissions were used to derive commissionable and override revenue.  In addition, cost allocation remained the same in both scenarios to best reflect the direct impact of charging service fees in this scenario.  These fees include front-end, back-end (cancellations, refunds and exchanges) and "other" (research) charges.

By strategically implementing a $16 service fee, the travel agency was able to reverse a -19.3% operating margin to +0.9%.  The fees served to generate an additional $9.24 in revenue per booking.  Of course, higher fees and a higher fee incidence (e.g., across all reservations) will illustrate a more significant return to the agency's operating margin.

**Table 15**
**Average Travel Agency Operating Margin, With And Without Service Fees**

| Total | Without Service Fees | With Service Fees |
|---|---|---|
| Revenue Per Booking | $45.39 | $54.63 |
| Cost Per Booking | $54.13 | $54.13 |
| Operating Margin | -19.3% | +0.9% |

Source:  PhoCusWright Inc.  Copying prohibited.

# Recommendations And Conclusion

From these data, PhoCusWright has determined that the shifts in market share between channels is making it challenging for traditional agencies to retain their market share among their existing base of customers. In fact, without deploying some or all of the strategies listed below, it will be difficult for travel agencies to survive.

## Recommendations

**1) Continue With Service Fees**

Overall, travel distribution is more efficient with the application of the Internet and Web-based tools. The Internet enables customer and agency to be better informed, so when it is time to book a trip, fewer questions need to be answered and the customer is pre-qualified. It has dis-intermediated the role of travel agencies for commodity products and has shifted the cost of distribution from the supplier to the customer. While the loss of commissions has jolted the industry and forced some travel agencies to close, the market has shifted to re-position (or re-intermediate) the travel agency as a valuable player in the distribution of travel. The travel agency is now positioned as the advocate of the buyer rather than a distributor of the supplier. This positioning should legitimize for agencies that they are charging fees for professional services provided, and not as subsidies for lost revenue. It is imperative for travel agencies, particularly small ones, to educate their customers of their value and be compensated for services rendered.

**2) Shift Product Mix**

As in any retail operation, business owners sell what is profitable and desired by the customer. The same is true for travel. Small shifts in the composition of products that an agency sells, will, over time, reduce costs and increase revenue for an agency. Commissionless and loss leader products serve only to drain a travel agency's resources and depress margins. Travel agencies must concentrate their efforts on products with the greatest opportunity for growth and that offer the highest levels of profitability. With approximately 10% of all adults having ever taken a cruise *(PhoCusWright's Selling Vacations And Cruises: The Online/Offline Challenge, December 2001)* and suppliers paying 15-20% commissions, there is tremendous opportunity to profit from cruises. With only 13% of vacation packages sold direct to consumers, the market expanding by 29% by 2004 and suppliers paying bonus commissions for GDS bookings (*PhoCusWright's Selling Vacations: The Online/Offline Challenge, May 2002*), travel agencies are well-incented to sell and profit, today, from niche vacation and tour products. However, higher margins for these products are not everlasting. It behooves travel agencies to be informed about what suppliers in this category are doing and how their distribution strategies will evolve over time.

**3) Adopt Web-Based Technology**

Both online and offline agencies are adopting low cost technologies to improve margins, target their product offerings and deliver more personalized service. As traditional agencies recognize the importance of the Internet as a complementary distribution channel to their services, they must increasingly use the Internet and leverage other Web-based tools to increase productivity. E-marketing tools enable agencies to use email as a direct marketing tool to target customers with tailored products based on their past patterns of purchase. E-marketplaces, such as Traveleye, provide agencies with the ability to make commissionable bookings through direct links to the Web sites of leading travel providers.  Customized "request-for-quote" services, like Respond Networks, enable travel agencies to respond to the hybrid purchaser who wants the online convenience combined with personalized, concierge-level services.  Web fare scan technologies scan Web travel sites for discounts, and, for a fee, enable agents to "guarantee" customers that that they are receiving the lowest fare without the customer having to search themselves.

In addition, to help capture the higher margins associated with more complex travel, online firms are deploying technologies that enable travelers to automatically or dynamically create their own personalized electronic packages (or E-Packs).  These products are being offered directly as well as through online agency providers.  Tools such as Site 59, Rail Europe's e-Vacations.com site, NeatTravel.com and Orbitz (through NeatAgent technology) will help increase their share of online vacation and tour packages over the next few years. NeatAgent technology also allows travel agencies to increase profitability on packages by choosing the commissions or margins they want to make on each sale before searching and selecting the inventory.  With cruise and tour product being an important component to profitability, it is imperative that smaller travel agencies use technology to streamline and automate the cruise and tour purchase process.

**4) Accessing Web Fares**

While it is true that Orbitz offers the most Web fares online, Web fares are also available on airline Web sites.  Some airlines provide selected Web fares through other online agencies as well, such as Expedia or Travelocity.  Offline agencies were previously at a disadvantage because they could not access Web fares for their clients unless they booked them directly on the airline Web sites or Orbitz.  New technologies are now available that enable travel agencies to access Web fares for their clients on the GDS or via their corporate booking tool.  GDSs are investing in these tools to help bridge this access gap.  Sabre, for example, currently offers Web fares to its travel agencies via FareChase's "screenscraping" technology, which "scrapes" Web fares from the supplier Web sites.  The Web fares are integrated on the GDS screen along with published fares, although the travel agent must book the Web fares on the airline Web sites.

Corporate travel agencies also have access to Web fares via various techniques.  For example, Orbitz provides its Web fares to Navigant customers via Navigant's Aqua software.  GetThere recently announced that its corporate customers can gain access to Web fares via its GetThere Multi-Source Engine.  Multi-Source Engine enables corporate clients to view and compare choices from all electronic distribution channels: GDSs, supplier Web sites, direct connections and other sources.  Web fares are available via screenscraping technology (tapping the airline Web sites), but are integrated into the GetThere booking engine so that travelers can compare negotiated rates, published rates and Web fares side by side.  A technique called "proxy booking" allows travelers to book Web fares within the same interface rather than having to link to the airline Web site to make the booking.

Thus, travel agencies can access and book Web fares for their clients; to make money, however, they must charge fees for these Web fares.  It is the fees that differentiate the offline from the online travel agency.  As indicated, a typical offline fee is $16, but can be as high as $60 per ticket.  Orbitz, on the other hand, charges a $10 fee per booking.  In addition, offline agencies must fight the *perception* that Web fares are only available online.

### 5) Capitalize On The Merchant Model

Offline travel agencies have also lost clients to online travel agencies that sell discounted hotel inventory via the "merchant" or markup model. This model enables the agency to add a 20% or higher markup to the hotel room. Expedia and Hotels.com are profitable because of their deals with hotels and their ability to sell rooms at a significant mark-up. While it is true that few small travel agencies can strike the same deals with hotels as their online counterparts, there are technologies available that enable travel agencies to offer merchant hotel inventory. Sabre, for example, recently introduced Sabre Exclusives, which enables Sabre agencies to have access to discounted hotel inventory, which they can sell for a 10% commission (paid by Sabre).

Services that provide travel agencies with Web fares, enable travel agencies to create dynamic packages or provide access to merchant fares and rates, will allow offline travel agencies to be price competitive with online agencies, and will temper the shift to online agencies. While pervasive in the hotel arena, the merchant model is migrating to non-hotel categories as well. Therefore, travel agencies must be informed of new business models in the marketplace and experiment with them in their own businesses.

### 6) Sell Value

There are a number of purchase dynamics impacting the channel of choice for leisure/unmanaged travel. Price continues to be a driving force behind online trial and usage for leisure/unmanaged travel. Consumers relate online travel agencies to good price; even those people who have yet to make their first online purchase believe that online travel agencies offer the best prices (*PhoCusWright 2001 Consumer Travel Trends Survey*). This means that when they do make their first purchase, it will likely be on an online travel agency site. In fact, *PhoCusWright's 2001 Consumer Travel Trends Survey* identified that half of all online travelers who have researched travel online bought that travel product offline. Today Web fares (without fees) and price promotions are driving first time or random buyers to agency sites. However, brands, not just low prices, will affect purchase loyalty over time. Those who buy a great deal of travel eventually become partial to a brand or brands, and use branded Web sites. (*PhoCusWright 2001 Consumer Travel Trends Survey*). Travel agencies must sell the value of their services and expertise over price to sustain long-term relationships with customers and be profitable.

### 7) Target Advertising To The Hybrid Community

Consumers are using a hybrid of channels through which to investigate and make their leisure/unmanaged purchases. As consumers use the Internet for more complex travel, they require more personalized, concierge-level service to support their purchase. PhoCusWright estimates that consumers who investigate product availability and price options online, and then purchase offline, complete approximately 15% of the offline travel agency bookings. In fact, many of these consumers will use different channels depending on the type of reservation being made. Advertising will help attract customers to think of you when researching online and booking offline. In fact, *PhoCusWright's 2001 Consumer Travel Trends Survey* identified that half of all online travelers report originally purchasing travel in this fashion and indicate that the Internet was responsible for originating their travel purchases. Advertising to the hybrid travelers will help stem the tide because half are willing to buy offline, many with a travel agency.

## Conclusion

In conclusion, while the percentage of offline agency users will decline over the next few years, there will always be, like in banking, a percentage of the population that prefers the in-person channel for making transactions. The traditional agency channel will remain financially viable if agencies operate as the buyer's advocate rather than a supplier's distributor. This underscores why an average of 90.7% of ASTA agency customers continue to use this channel for travel purchases (*American Society of Travel Agent's 2001 Service Fee Report*). And, technology no longer discriminates, because even small agencies have access to GDS and other Web-based tools to operate a more profitable business. Success in this industry, today, is all about marketing and business fundamentals. This includes: optimizing overhead, maximizing performance, maintaining and mining customer relationships, leveraging technology and the Internet, negotiating with suppliers, using a balance sheet discipline and receiving compensation for professional services provided. In this environment there is no room for error. Even if the economy improves, only those agencies that have relationships with customers, suppliers and specialize in niche cruises and tour packages will survive. These issues impact agencies of all sizes.

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